



# ACCREDITATION REVIEW TEAM REPORT

Department of Financial Institutions  
Credit Union Division  
State of California



January 2009

***CONFIDENTIAL***

## **TABLE OF CONTENTS**

	<u>Page</u>
Summary of Review	3
Purpose of Review and Scope of Review	5-6
Description of Division	7-8
Overview of Findings, Scores and Recommendations	10
Department Administration and Finance	11-16
Personnel	17-20
Training	21-24
Examination	25-29
Supervision	30-32
Legislative Powers	33-34
Final Score Sheet	35
Biographies of Team Members	36-37

## **SUMMARY OF REVIEW**

The Re-Accreditation Review Team (ART or Team) recommends unanimously to the NASCUS Performance Standards Committee (PSC) that the California Department of Financial Institutions, Credit Union Division be re-accredited by the National Association of State Credit Union Supervisors (NASCUS) for a five-year period beginning at the time of re-accreditation approval by the PSC, subject to annual review by the PSC.

NASCUS re-accreditation standards require a state agency to score 75 percent or more in each of the six sections of the Self-Evaluation Review for Accreditation (SERA). The ART believes that the agency meets the standards in all six areas. The third column from the left on the final score sheet on page 35 headed "ART Score" shows the scores applied by the ART 1,712 points and a percentage grade of 87.8%.

The ART made recommendations in the Department Administration and Finance, Personnel, Training, Examination, and Supervision Sections of the Review. The agency's next annual review should address progress and improvements in these areas and on topic areas rated "3" by the ART.

Areas for improvement and ART recommendations:

<b><u>Area</u></b>		<b><u>Rating</u></b>
<b>Section II – Personnel</b>		
II-E	Performance Appraisals	3
<b>Section III – Training</b>		
III-C	Provide On-the-Job Training	3
<b>Section IV – Examination</b>		
IV-G	Internal Review of Examination Reports Senior Staff Review of Reports	3

### **ART Recommendations:**

#### **Section I – Department Administration and Finance**

- 1) That the agency develop a written policy on holding regularly scheduled staff meetings;
- 2) That an agenda be prepared for all staff meetings;
- 3) That minutes be recorded for all staff meetings;

## **Section II – Personnel**

- 1) That position descriptions be reviewed annually to ensure descriptions are in place for all positions and that they are up-to-date;
- 2) That the performance appraisal process be reviewed and a tracking system implemented to ensure timely completion during the new employee probationary period and at least annually for all employees;
- 3) That the performance appraisal process include written documentation in the form of a signed and dated appraisal form and position description.

## **Section III – Training**

- 1) That a training manual be developed that includes state-specific references and resources;
- 2) That the agency continue development of the credit union examiners' new curriculum and performance matrix;
- 3) That the training program for new hires include courses in professional development;
- 4) That the training coordinator have access to the training database;
- 5) That the on-the-job training program be formalized to ensure consistency in training new hires, and that it include a system for tracking examiner training assignments, trainee comprehension of tasks, and identification of additional training needs.

## **Section IV – Examination**

- 1) That the agency consider establishing report turnaround standards based on the time between the conclusion of field work and transmittal of the final report to the institution;
- 2) That an examination tracking system be developed to monitor and manage report processing times to ensure timely transmittal of completed examination reports to boards of directors.

## **Section V – Supervision**

- 1) That a summary report form be developed to identify high risk credit unions.

## **PURPOSE OF REVIEW**

The State of California Department of Financial Institutions (DFI) Credit Union Division was re-accredited by NASCUS in 2004 and has submitted its application for re-accreditation and the Self-Evaluation Review for Accreditation (SERA). The purpose of the current review is to determine whether the Division meets NASCUS accreditation standards and whether it should continue to be accredited. The ART examined the capability of the agency to:

- Fulfill its statutory responsibilities to charter, regulate, examine and supervise all state chartered credit unions under its jurisdiction.
- Create and maintain a competent regulatory program.
- Produce high quality examination.
- Enforce all relevant statutes.

In the report that follows, the term “Department” or “agency” refers to the Department of Financial Institutions. “Division” refers to the DFI’s Credit Union Division.

## **SCOPE OF REVIEW**

The ART evaluated the department's ability to meet the standards required for NASCUS accreditation in six designated areas:

- Department Administration and Finance
- Personnel
- Training
- Examination
- Supervision
- Legislative Powers

The review was conducted primarily on-site at the California DFI offices in Los Angeles and San Francisco, California, and was based on several sources of information:

1) Extensive documentary evidence relating to:

- Management and organization of the agency;
- Methods of regulation and supervision (including the agency’s statutes, rules, and statements of policies);
- Supervision of troubled credit unions;
- Scheduling of examinations;
- Clarity, completeness and findings of credit union examination reports;
- The agency’s enabling legislation and the legal framework for the regulation of state chartered credit unions;

- Policies and procedures of the agency.
- Materials prepared by the agency concerning its ability to meeting standards in the six designated areas.

The team reviewed a random sample of examination reports and other files of both troubled and healthy institutions. All of the documentation was thoroughly reviewed by the ART members prior to or during their on-site visit.

Seven interviews and several follow up discussions were conducted with key agency personnel. The dialogues covered policies and procedures and investigated the reasoning behind the assigned ratings in the Accreditation questionnaire.

The review required five days on-site by the ART. The team held an off-site orientation meeting the day before going on-site, and private daily wrap-up and planning meetings during the five-day period.

The ART conducted an exit conference with the Credit Union Division deputy commissioner and the chief examiner .

## **DESCRIPTION OF THE DEPARTMENT**

The California Department of Financial Institutions is responsible for the licensing, regulation, and supervision of the state's banks, credit unions, savings and loans, and trust companies and for administering state laws regulating those institutions.

In 1997, the Department of Financial Institutions was established by statute for the purpose of combining the regulation of all depository institutions within one department. Prior to 1997, regulation of state-chartered credit unions was under the Department of Corporations and the regulation of banks was under the State Banking Department. The Department of Financial Institutions is one of fifteen departments within the Building, Transportation and Housing Agency, an office within the Executive Branch whose Secretary is a member of the Governor's Cabinet.

The Department of Financial Institutions is organized into six functional areas: Legal, Administrative Services, Legislation, Banking, Money Transmitters, and Credit Unions. The purpose of the Department of Financial Institutions and the Division of Credit Unions is defined in the California Financial Code. The Code designates the commissioner as the chief executive of the DFI and the deputy commissioner as the chief officer of the Credit Union Division. The Code's credit union section states that the "Deputy Commissioner of Financial Institutions for the Division of Credit Unions shall administer the laws of this state relating to credit unions or the credit union business under the direction of and on behalf of the Commissioner."

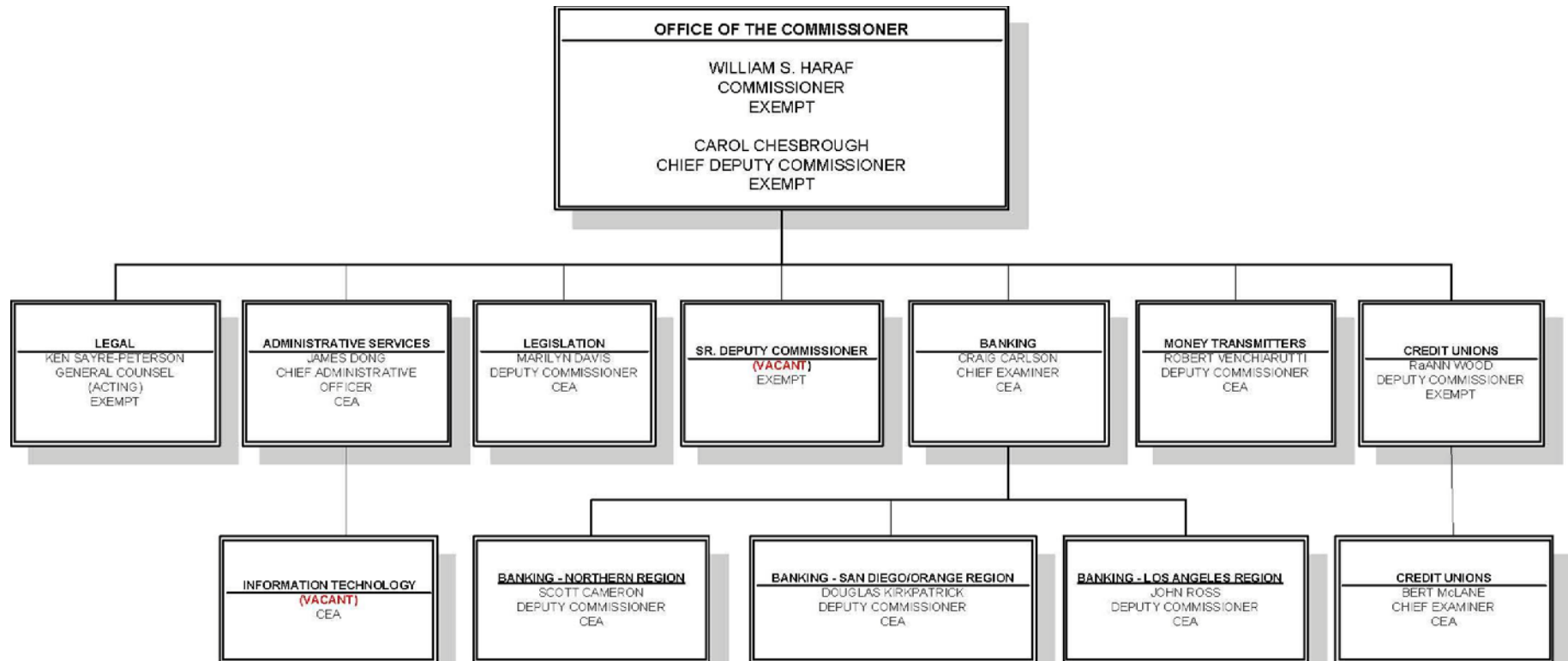
The statute provides for the creation of a Credit Union Advisory Committee to advise the deputy commissioner for Credit Unions on credit union matters. The Committee is part of the Business, Transportation and Housing Agency, and its seven members are appointed by the secretary. Committee members are appointed to two year terms, and may be re-appointed. The statute requires that the Advisory Committee meet at least once annually and states that rules and regulations governing the Committee and its members may be prescribed by the commissioner. In addition to serving in an advisory capacity to the Commissioner, the Committee assists in the relaying information from the Department to the credit unions.

The Division of Credit Unions is organized along geographic lines, with offices located in San Francisco, Los Angeles, Sacramento and San Diego.

In addition to the commissioner and deputy commissioner, the Division is staffed by 53 employees, which includes the chief examiner, assistant chief examiner, the financial institutions supervisors and managers, senior financial examiners, financial examiners, and an office technician. The Division is responsible for the examination and supervision of California's 171 federally-insured state-chartered and 15 privately-insured state-chartered credit unions with total assets of approximately \$72 billion.

DECEMBER  
2008

# DEPARTMENT OF FINANCIAL INSTITUTIONS EXECUTIVE OFFICE ORGANIZATION CHART



## **OVERVIEW OF FINDINGS, SCORES AND RECOMMENDATIONS**

The ART's findings, scores and recommendations in each of the six designated areas are set forth in the following pages. After the discussion of the six areas, there is a final score sheet for the department.

The rating scale is as follows:

		Rating
<b>Excellent</b>	Strength obvious and no weaknesses perceived.	5
<b>Very Good</b>	Department performance is strong but minor improvements in the area covered by the criterion could be made.	4
<b>Marginally Acceptable</b>	Significant improvements are necessary	3
<b>Below Average</b>	Material improvements are clearly needed	2
<b>Poor:</b>	State credit unions and public poorly served.	1

The score in each element of the Ratings Sheet is derived by multiplying the "value" of the element by the ART's rating.

## **I. DEPARTMENT ADMINISTRATION AND FINANCE**

### **FINDINGS**

#### **Mission of the Department**

The mission and purpose of the DFI and the Credit Union Division are clear and are effectively communicated to staff and the public. The purpose of the Credit Union Division is defined in the California Financial Code which charges the Division with the execution of the laws of the state relating to credit unions. The mission and purpose statement forms the basis for the department's strategic plan, development of goals and objectives, and the budgeting process.

The strategic plan contains a statement of the DFI overall goal to be a leader in the regulation and supervision of the financial services system, and describes the Department's commitment to specific goals and objectives in executing its regulatory and supervisory responsibilities.

The state budget contains a purpose statement for each department and program. It specifically addresses the credit union program and outlines its responsibilities in enforcing the provisions of the Code relating to credit unions.

The mission statement is posted in the agency's offices and described on the department's website. The ART noted the efforts of management to communicate awareness of the Department's mission among agency staff, and the team's interviews with staff found a clear understanding of the mission of the Department and their individual responsibilities as DFI employees.

#### **Organization of Personnel**

The organizational charts for the DFI and the Division are detailed and clearly depict lines of authority, geographical areas of responsibility, and functional accountability. The chart, which is required to be approved by the Department of Personnel Administration (DPA) is updated as it becomes necessary. The organizational chart defines the executive management structure, supervisory positions, examiner and clerical positions, as well as administrative support positions, including budget, personnel, information systems, legislative and legal support.

Several new examiners were recently hired, and the agency is in the process of filling additional vacancies and re-assigning some responsibilities. However, the ART found the organizational charts to be current and notes that they will be updated further to reflect additional changes.

#### **Promulgation of Rules and Regulations**

The Administrative Procedures Act (APA) governs the promulgation of rules and regulations

by all state agencies. The APA, defines the process for initiating a regulation, and addresses the process for publication, comment period, and rulemaking review by the Office of Administrative Law (OAL) for compliance with the APA. Final regulations must be filed with the Secretary of State within one year. If all procedures are completed within the earliest time, the promulgation of a regulation can occur in four months. All rules must be adopted through formal regulation.

The parity provision of the Financial Code gives state-licensed credit unions parity with federal credit unions for permissible activities. Regulations promulgated under the parity provision expire two years from the calendar year in which the parity regulation was issued. Extension of the regulation requires enactment of the regulation into statute. The law authorizes the adoption of emergency regulations, sets forth requirements and procedures for filing an emergency regulation and extending or making the regulation permanent. Emergency regulations become effective upon filing and can remain in effect up to 180 days.

### **Applications**

The commissioner's authority to approve applications for new charters, conversions, field of membership changes, by law revisions and mergers is granted in the Financial Code. The Code defines the requirements the applicant credit union must meet, grants the investigative authority of the commissioner in reviewing applications, and establishes the grounds on which the commissioner may approve or deny an application.

The agency has a system for tracking the processing and approval of applications and preparing processing reports. The ART review found the tracking system to be adequate and reports to be detailed, but noted instances where there were fields not completely filled in.

### **Relationship with NCUA and Regulators from Other States**

Communications with the federal regulator are open, and the working relationship is effective. A written Program Plan agreement provides guidance on scheduling, assignments, and supervision and enforcement actions. The plan is reviewed and updated periodically. Division managers meet with NCUA regional managers quarterly to discuss plan issues, problem credit unions, and the scheduling of joint examinations.

The relationship between the Division and NCUA regarding call reports, information sharing, merger, conversion, and enforcement issues is cooperative and effective overall. Enforcement actions are agreed upon by both agencies, and examiners from both agencies participate in exit conferences.

DFI credit union management and staff are in regular contact with other state regulators and are able to effectively obtain and share information for comparative or research purposes. Managers and examination staff involvement in NASCUS events, including regulator conference calls and meetings, educational offerings, and committees and working groups, provide additional opportunities to interact and share information with other state regulators.

The DFI participates in the Nationwide Cooperative Agreement for the Supervision of State

Chartered Credit Unions Operating in a Multi-State Environment. DFI receives examination reports for out-of-state credit unions doing business in California, has been invited to participate in the examination of the U.S. Central Credit Union, and participates annually in the examination of the private insurer by the State of Ohio.

### **Staff Meetings**

The ART notes the implementation of a written communication plan to document the expected level of communication and help promote efficiency of communications within the Credit Union Division. Department and Division staffs meet periodically, and although the ability to do so has been impacted budget issues, the Department's goal is to schedule an all-staff training conference annually.

The ART noted a need for improvement in the system for holding and conducting staff meetings and made recommendations that 1) the policy on staff meeting frequency be reduced to writing; 2) that an agenda be prepared for all staff meetings; and 3) that minutes be recorded for all staff meetings.

Staff meetings among senior Department executive committee management staff are held monthly to discuss Department-related issues, and the Credit Union Division managers also meet monthly to discuss regulatory issues.

### **Access to Legal Assistance**

Legal assistance is provided to the Department and the Credit Union Division by the Department's general counsel and Legal Division, which consists of seven attorneys, one of which is assigned to assist in credit union-related issues. The Legal Division's functions include assisting with drafting regulations and rules summaries; providing assistance, if necessary, with the review and processing of applications; providing legal advice and opinions on laws administered by the Department; and representing the Department in administrative proceedings. If necessary, and with the approval of the State's Attorney General, the Department may also contract with outside legal counsel. Representation in lawsuits against the Department is provided by the California Attorney General's office.

Examiners and department personnel have access to federal laws and regulations through the NCUA electronic library, to state laws and regulations, and DFI legal opinions. Department letters, precedents and interpretations are available to staff and the public on the DFI website's Legal Precedent System. Senior staff has access to the LEXIS/NEXIS legal research system.

### **Agency Facilities**

The agency's facilities provide ample workspace for office staff and examiners, conference room space for meetings, and locked storage of confidential files and examination reports. The San Francisco and Los Angeles offices are located in the cities' financial districts where they are accessible by public transportation. Paid parking is available nearby. The San

Francisco office, to which the agency recently moved, is spacious and provides expanded space for work, meetings, and storage.

Visitors to both offices must pass through security. The agency's offices are locked, accessible to employees by a coded pass key, and accessible to visitors by employee escort. Security measures are also in place in the San Diego and Sacramento offices. The San Diego offices remain locked and restricted to employee entry. The Sacramento offices are unlocked during business hours, but entry to the agency work space requires an electronic pass card. Both offices have lockable file rooms for storage of confidential files and examination reports.

### **Emergency Planning and Disaster Recovery**

The DFI has an emergency planning, disaster recovery, and continuity of business operations plan in place. The Continuity of Operations/Continuity of Government (COOP/COG) provides direction on emergency relocation and restoration of operations. It identifies essential functions, contains a licensee, government agency and staff communications plan, identifies lines of succession delegation of authority for senior management, and transfer of responsibility.

The plan addresses relocation of employees and alternate work locations, including teleworking arrangements. It is designed to ensure that critical functions are uninterrupted, to minimize disruptions, and to provide for restoration of operations as expeditiously and efficiently as possible.

The plan is a work in progress, and it was most recently revised in 2008. The plan has not been fully tested, and the ART encourages the agency to do so.

### **Technology**

The ART's review found the agency's systems to be adequate and up to date and agency personnel make effective use of technology for maintaining the website and information list-serves, communications, examination and licensee information, and off-site monitoring. The servers provide capability for sharing files, printing, email, web filtering, and blackberry services. Servers are backed up nightly, with a full back up weekly. Firewall, anti-virus, email scanning, encryption, and internet filtering software is in place.

A local area network connects the agency's four offices and provides remote access to the DFI server by teleworkers and non-credit union field examiners through either a dial-up connection or VPN. Credit union examiners use NCUA-leased notebooks at the AIRES examination software. Security features on the NCUA notebooks restrict access by credit union examiners to the department's remote server and DFI email, but they are able to access the internet and the Department's intranet and other resources through their NCUA-issued laptops.

Credit union examiners use NCUA-leased laptops and the AIRES examination program. The

Department is exploring replacing NCUA laptops with Department-owned laptops to address the remote access issue and the limited number of laptops available through NCUA.

### **Agency Budget**

The Department of Financial Institutions is funded solely from annual assessments and examination fees and receives no funding from State's general fund. The Credit Union Law empowers the commissioner to levy annual assessments based on asset size, up to a limit of \$2.20 per \$1,000 in total assets, to determine the date on which the assessment is based, to invoice the credit union annually, and to charge examination fees.

The budget process begins with the deputy commissioners preparing program Budget Change Proposals (BCPs), which are reviewed and approved by the commissioner. BCPs use the current fiscal year budget as a base and consist of a narrative and submission of workload data in support of changes in the budget. The budget officer is responsible for the preparation of the annual budget, which is reviewed by the Office of the Legislative Analyst and Budget Committees of the Legislature, and if necessary, adjusted based on executive orders or directives, and processed through the Business Transportation and Housing Agency and the Department of Finance. The commissioner, deputy commissioner and chief administrative officer may also present and defend proposed department budgets before the Legislature and the governor's office.

Revenue from the examination and supervision of credit unions is sufficient to support the agency's examination and supervision functions. Revenue continues to increase as the result of growth in assets under supervision. Department's budget has been adequate to enable it to meet its statutory examination frequency requirements, however, it is noted that the increase in credit union assets and complexity, additional examination requirements in the area of compliance, the NCUA compressed examination cycle, an increase in on-site contacts, and current economic conditions have resulted in increased workload for the Department.

While revenue continues to meet funding requirements, the agency is subject to state required spending restraints; however, the Credit Union Division was recently successful in acquiring 16 additional examiner positions.

### RATINGS SHEET (Department Administration and Finance)

	Value x 5	ART Rating	ART Score
A. Mission Statements	5	5	25
B. Organization of Personnel Chart	5	5	25
C. Promulgation of Rules & Regulations	4	4	16
D. Timeliness on Applications	7	5	35
E. Communication with Federal Agencies	7	5	35
F. Communication with Other SSAs	7	5	35
G. Periodic Staff Meetings	6	4	24
H. Access to Legal Assistance	7	5	35
I. Agency Facilities/Equipment	5	5	25
J. Disaster Recovery Plan	7	4	28
K. Computer System	7	5	35
L. Source of revenue	7	5	35
M. Budget Procedures	5	4	20
N. Budget Adequacy	10	5	50
O. Budget Justification/Defense	5	5	25
Total	470		448
			95.32%

***Recommendations:***

- 1) That the agency develop a written policy on holding regularly scheduled staff meetings;
- 2) That an agenda be prepared for all staff meetings;
- 3) That minutes be recorded for all staff meetings;

## **II. PERSONNEL**

### **FINDINGS**

#### **Personnel Manual**

The Department's policy and procedures manual is available to all employees on-line. DFI employees are subject to federal and State of California employment law and regulations.

DFI examiners and support staff are represented by the California State Employees Association and the Department is subject to the collective bargaining agreement that outlines salaries, wages, and working conditions. The collective bargain contract consists of negotiated Memoranda of Understanding, which in addition to salaries and wages, address hours of work and overtime; holidays and leave policy; business and travel allowances; training and career development; position classifications; telework policy; work and family; standards of conduct; layoffs and retirement; and grievance and arbitration procedures. Employee representatives and representatives of the State Department of Personnel (DPA) participate in the contract negotiation process.

#### **Job Descriptions**

The DFI reorganized in 2008 and updated the position duty statements accordingly. However, the ART noted that the chief examiner position does not have a position duty statement and the position statement for the associate government program analyst position needs to be updated. The team recommends that job descriptions be reviewed annually. In view of the recent reorganization, the team believes it is important do so and to modify the statements as needed.

The agency uses forms provided by the DPA and State Personnel Board. These documents summarize the duties and responsibilities of all classifications, examples of the type of work performed, and the minimum education requirements for each classification. Examiner job descriptions are combined into a series, which includes the financial institutions managers and supervisors, the senior financial examiners, and financial institutions examiners ranges A, B and C.

Position duty statements are the basis for allocating positions, recruitment, examination structure, salary administration, status within each class, and performance evaluations.

#### **Recruitment and Hiring**

The agency's recent ability to hire several new qualified examiners indicates that, while subject to collective bargaining requirements, the recruitment and hiring process is adequate.

Applicants for entry level examiner positions are required to meet minimum qualifications and pass an examination to be considered for a follow up interview. The DFI commissioner is the hiring authority for the department but may delegate the selection to deputies and

managers.

The agency has the ability to advertise for positions and recruit applicants from various sources, including colleges and universities, financial institutions or other state agencies.

### **Salaries and Benefits**

Salaries and benefits for non-management positions are determined through collective bargaining with the State Department of Personnel Administration. The compensation and benefits for managers are considered consistent with those of employees covered by the collective bargaining agreement. Wages are considered marginally competitive and, combined with the stability of state government employment, they have enabled the DFI to attract well-qualified candidates.

Benefits include paid vacation, sick leave, medical, dental and vision care, life insurance and a retirement plan. Benefits are considered good; however, examiner salaries are lower than those of federal examiners who receive a pay differential based on geographic location and cost of living. Examiners who travel more than 50 miles to the job site are expected to stay out and are paid a per diem of \$75 plus the cost of hotel.

The agency has proposed a pay differential for the financial examiner job series, which received a favorable response from the DPA, but the DFI does not have the budget authority to fund the differential at the present time.

The ART's review of the comparative salary analysis found that the information available was outdated. A salary comparison task force had been organized, but has been inactive. The team suggests the task force be reinstituted and that an up-to-date comparative salary analysis be completed.

### **Performance Appraisals**

The ART found that it is evident that the DFI has the requisite tools with the Individual Development Plans (IDPs) and the Performance Appraisal Summary (PAS) forms, but noted that the documents are not being fully utilized. The team recommends that the process be reviewed to ensure it includes the following:

- Written documentation of the appraisal evidenced by a signed and dated IDP and PAS;
- A tracking process to ensure all employees receive a performance review;
- A system to ensure performance reviews are completed during the employee's probationary period and at least annually thereafter.

The above recommendations are also based on the ART's findings of inconsistency in the completion of performance evaluations within the timeframes outlined in the Department's Policy and Procedures Manual and the requirement regarding performance appraisals during the probationary period and annually for permanent employees.

## **Organizational Structure and Examiner Career Path**

The organizational structure provides opportunities for promotion and career advancement. The ability to advance through the examiner career path is based on time in grade and testing requirements for the next level. Entry level examiners are hired as Range A Financial Institutions Examiners. After satisfactory completion of the one-year probationary period, they are promoted to Range B and become eligible for promotion to Range C after successfully completing one year as a Range B examiner. Eligibility for promotion to manager, supervisor, or senior examiner is based on time in grade and on vacancies and scores earned on testing for these positions.

The ability to earn qualifying experience to meet the requirements for the California Certified Public Account license through employment in the credit union examination program provides another opportunity for professional advancement.

In the Examination Section of this report, the ART notes a high reliance on NCUA for specialized examination expertise and suggests that the agency strengthen in-house capability in this area. While the examiner levels provide opportunity for advancement, the team suggests that having the ability to specialize in areas such as IT and compliance examination will provide additional career path opportunities for examiners.

## RATINGS SHEET (Personnel)

II. Personnel	Value x 5	ART Rating	ART Score
A. Personnel Manual - Completeness/Relevancy	4	4	16
B. Job Descriptions (Evaluate)	5	4	20
C. Hiring Policies (Adequacy)	5	4	20
D. Adequacy of Salaries/Benefits	7	4	28
E. Performance Appraisals/Review	5	3	15
F. Organizational Structure/ Career Path	6	4	24
Total	160		123
			76.88%

### **RECOMMENDATIONS:**

- 1) That position descriptions be reviewed annually to ensure descriptions are in place for all positions and that they are up-to-date;
- 2) That the performance appraisal process be reviewed and a tracking system implemented to ensure timely completion during the new employee probationary period and at least annually for all employees;
- 3) That the performance appraisal process include written documentation in the form of a signed and dated appraisal form and position description.

### **III. TRAINING**

#### **FINDINGS**

The agency recognizes the importance of training, and emphasizes in-house and external training for new and experienced examiners.

The DFI recently hired several new employees and continues to seek qualified candidates for the remaining vacant positions. Agency management and the ART concur in acknowledging that the number of new examiners presents challenges in ensuring that they receive required training, both formal and on-the-job. The ART made recommendations and suggestions for improving the training program, particularly as it relates to the several recently hired examiners.

#### **Training Policy and Training Coordinator**

Recognizing that the assistant chief examiner has responsibility for oversight of the training program, the ART made several recommendations and suggestions for the assistant chief examiner to consider as training coordinator:

- Continue to hold staff department-wide staff meetings at least annually (a recommendation relating to staff meetings is made in Section I of this report);
- Develop a training log to track in-house and outside training courses;
- Ensure that the assistant chief examiner has access to the training database;
- Continue development of the Credit Union Division's new curriculum and training matrix;
- Develop a training manual that includes state-specific material;
- Provide training for conducting exit meetings; DFI management anticipates that the recently-hired examiners will have sufficient training to prepare them to serve as EIC in approximately one year. The team suggests that this training should allow for participation in exit meetings and possibly holding mock exit meetings in which examination staff can practice their presentation skills and receive feedback;
- Develop and implement an on-the-job training program, which includes a method of tracking examiner trainee assignments, comprehension, and identifying additional training needs;
- Improve consistency in training through a mentoring program.

#### **Training Materials**

Examiners have access to training materials made available through courses provided by NCUA, NASCUS, CSBS, FFIEC, FDIC, and the Federal Reserve. There is no formal training manual for credit union training. The ART recommends that a credit union examination training manual be developed and that it include state-specific examination procedures, references, and resources.

In addition to the materials provided through technical training, other available training materials include information obtained from participation in the Department's Leadership Development Program, web-based training, continuing education, and state required training in ethics, and compliance with employment and workplace laws.

### **On-the-Job Training**

On-the-job (OJT) training is designed to give new credit union examiners practical work experience to complement formal training. The ART recommends that the OJT program be formalized, particularly in view of the number of recently-hired new examiners. The ART recommends that in developing a formal OJT program, it include a method of tracking examiner assignments, trainee comprehension of tasks, and a way of identifying additional training needs and providing feedback on progress. The ART further believes developing a mentoring system will improve consistency in new examiner OJT.

On-the-job training varies according to individual examiner experience and ability. It includes participating in examinations of credit unions of various sizes and complexity, working with an examination manager and experienced examiners and examiners-in-charge. The trainees work product is reviewed by the EIC, who provides feedback to the trainee, but as discussed previously, the ART recommends that a system be developed for documenting and tracking progress and performance.

Experienced examiners also receive OJT in gaining additional experience and proficiency on increasingly complex and difficult credit union examinations. Communications among examination staff and supervisors and managers is effective in enabling examiners to obtain guidance and answers to questions on examination-related issues.

### **External Training, Continuing Education on Emerging Issues**

The DFI training policy permits reimbursement for tuition and the cost of materials, as well as leave to attend outside training, provided the training is job-related and meets the criteria with respect to the Individual Development Plan (IDP) and the mission and goals of the Department. The percentage of reimbursement costs varies depending on whether the training is assigned by the employee's supervisor. If assigned by the supervisor, 100% of the cost is covered. If the training is not assigned, 50% is covered. The policy on outside training is guided by the training requirements of the job classification and is designed to provide career movement opportunities in current classifications or other job categories.

Continuing education on emerging issues is encouraged throughout an examiner's career. Sources for training on specialized topics include technical training provided by NCUA and other federal agencies, NASCUS, and private vendors. Recent training includes courses and seminars on topics such as specialized and indirect lending, capital markets, derivatives, and information technology and electronic financial services systems. Training on specialized topics and emerging issues is also provided in-house during the all staff training conferences and through the use of online training and training CDs.

## **Training Budget and Expenditures**

The training budget and expenditures are sufficient to provide examiners with necessary training. The budget for the past three years shows an increase in training expenditures for the credit union program. The level of participation by examiners in training opportunities also indicates that adequate resources are available to enable the agency to meet examiner training needs.

### RATINGS SHEET (Training)

III. Training	Value x 5	ART Rating	ART Score
A. Training Coordinator/Written Policy on Training	10	4	40
B. Training Materials	6	4	24
C. Provide on-the-job training	8	3	24
D. Method for Continuing Education	7	4	28
Education on Emerging Issues			
E. Policy for External Training	5	5	25
F. Adequacy of Training Funds	10	5	50
Total	230		191
			83.04%

#### ***Recommendations:***

- 1) That a training manual be developed that includes state-specific references and resources;
- 2) That the agency continue development of the credit union examiners' new curriculum and performance matrix;
- 3) That the training program for new hires include courses in professional development;
- 4) That the training coordinator have access to the training database;
- 5) That the on-the-job training program be formalized to ensure consistency in training new hires, and that it include a system for tracking examiner training assignments, trainee comprehension of tasks, and identification of additional training needs.

## **IV. EXAMINATION**

### **FINDINGS**

#### **Examination Frequency - Statutory Requirement and Department Policy**

The agency has been able to meet the statutory requirement that all credit unions be examined at least once every two years. The Division's policy is to examine all credit unions once every 18 months and high or increasing-risk and problem credit unions more frequently. Actual frequency for regular full examinations, other than those identified for more frequent examinations or contacts, is approximately 20 months between examinations. Interim contacts or examinations of troubled institutions are limited in scope to the problem areas.

#### **Examination Manual**

Credit union examiners use the NCUA Examiner's Guide and the DFI Credit Union Examiner's Manual. The DFI manual provides instructions on examination procedures and background information. Additional state-specific resources, including the credit union laws and regulations, department rulings, etc. are available online. Examiners are also provided with a copy of the AICPA Audit and Accounting Guide for Depository and Lending Institutions.

#### **Examination Capabilities**

With the exception of the recently-hired examiner trainees, Division examiners are trained, experienced and proficient in the examination of all areas of credit union operations; including loans; investments; asset/liability management/liquidity, financial analysis; management; and off-balance sheet items. The ART addresses the matter of new examiner training in the examination areas in more detail in the Training Section of this report.

The ART noted a high degree of reliance on NCUA for specialty examination expertise such as information technology and Bank Secrecy Act compliance examinations. While needs are currently being met, in the long term-term, the agency should consider strengthening expertise in these areas within the agency.

Forty of the Division's 54 positions are dedicated to examining credit unions. The experience level ranges from just newly hired to more than 30 years. Most of the Division's experienced examiners have worked with NCUA examiners and some have participated with NCUA in the examination of the corporate credit union. Examiner positions were recently added to focus on member business lending, subprime lending and information systems and electronic banking examination functions. Other than the newest examiners who are in the process of completing core training, all examiners have received training in regulatory compliance.

#### **Examination Scheduling and Planning**

The Division's two credit union portfolio managers are responsible for planning and

scheduling examinations, with input from the examination managers, supervisors, and the chief examiner.

Scheduling is based primarily on level of risk based on the prior examination, interim financial reports, and off-site monitoring. Examination schedules are prepared monthly extending out approximately two months.

Joint examinations are coordinated with the NCUA. The Program Plan, the DFI's agreement with NCUA Region V, provides guidance on which examinations will be conducted jointly, division of examination work among state and federal examiners, and the handling of examination findings, ratings, presentation of reports, and resolution of problems.

### **Examination Report Quality, Review and Processing**

The ART found that examination turnaround time and the process for measuring turnaround time needs improvement. In order to more accurately measure and monitor the efficiency of examination processing, the agency should consider establishing turnaround standards based on the time between the conclusion of field work and transmission of the final report to the institution.

Currently, the agency calculates turnaround time from the date of the board of directors meeting. NASCUS accreditation standards base examination turnaround time on the interval between completion of field work and transmittal of the completed report to the credit union. The ART noted some examinations for which the board meeting did not occur until two to three months after completion of the field work.

An examination tracking system should be developed to monitor and manage report processing times to ensure boards of directors receive the completed report in a more timely manner, particularly in view of the increasing volume and severity of problem institutions.

The ART conducted an extensive review of examination reports and found them to be well-written and good quality overall. The reports were prepared by various examiners and varied with respect to the size, complexity and condition of the credit union. The team also noted that an examiner in the San Diego office is assigned to assist in reviewing examination reports.

Credit union examiners use the AIRES examination software and forms, supplemented by additional state-specific forms to evaluate the credit union's organizational structure and any state regulatory concerns. The state-specific forms are reviewed and updated regularly to reflect changes in laws, rules, policies, or procedures.

Examination reports are reviewed internally by the supervisor or senior examiner to ensure accuracy and completeness. The review process includes and analysis of work papers and accuracy of the written report, and written comments are provided to the examiner. Final examination reports are issued and signed by the supervisor. Cover letters to accompany the examination report are drafted by the examiner-in-charge for signature by the supervisor.

Transmittal letters follow an established format summarizing the credit union's condition, definition of codes, and include a section that focuses on specific findings and concerns contained in the examination report.

### **Exit Conferences**

With the exception of the new hires, examiners are trained and experienced in conducting exit conferences. With respect to trainees, the ART made suggestions in the Training Section of this report to facilitate the training of new examiners in exit conference and presentation techniques.

At the conclusion of each examination, the examiner-in-charge meets with the credit union's board of directors and senior management to discuss examination findings. In conducting the exit conference, the examiner-in-charge reports on findings and their impact on the credit union's condition. Depending on the findings and whether there are serious regulatory concerns, the EIC's supervisor, the chief examiner, or the deputy commissioner may also attend the exit conference.

### RATINGS SHEET (Examination)

IV. Examination	Value	ART Rating	ART Score
A. Frequency of Exams	10	4	40
B. Exam Manual	6	4	24
C. Scope of Exam Capabilities			
1. Operational Areas			
a. Loans (including member business and insider training)	8	5	40
b. Investments	8	5	40
c. Asset/Liability Management	8	4	32
d. Liquidity	8	5	40
e. Financial Analysis	8	5	40
f. Management	8	5	40
g. Off-Balance Sheet	8	5	40
2. Ability to Examine EDP for:			
a. Users	8	4	32
b. Providers	8	4	32
3. Electronic Financial Services	8	4	32
4. Compliance	8	4	32
5. CUSOs	8	4	32
D, Planning Exams	10	5	50
E. Clarity and Completeness of Exam Report/System for Report Review	10	4	40
F. Exit Conferences	6	5	30
G. Internal Review/Return of Exam Reports/Senior Staff Reviews	10	3	30
Total	740		646
			87.30%

***RECOMMENDATIONS:***

- 1) That the agency consider establishing report turnaround standards based on the time between the conclusion of field work and transmittal of the final report to the institution;
- 2) That an examination tracking system be developed to monitor and manage report processing times to ensure timely transmittal of completed examination reports to boards of directors.

## **V. SUPERVISION**

### **FINDINGS**

#### **Surveillance and Off-Site Monitoring**

The 5300 Call Reports, NCUA Financial Performance Reports, and the DFI's risk management reports, examination data and the credit union audited financial statements are used to monitor trends and identify unusual trends and problems. The data, the reports generated from the data, and the Department's in-house early warning system are used for follow up monitoring and to determine whether a credit union should be subject to closer surveillance.

The Department's early warning system, FIMis, combines call report and examination data to identify institutions with greater risk. The Department also uses the Callahan's Peer-to-Peer software, along with the collection of 5300 data, to capture and monitor key elements by asset grouping and ranked quintiles to track credit union trends. Problem credit union reports are distributed and discussed monthly by the commissioner, deputy commissioner, chief examiner, portfolio managers, and examination managers. A Problem Licensee Committee receives a report each month on credit unions with serious problems or with a composite CAMEL rating of 4 or 5.

The off-site monitoring reports and early warning systems provide the agency with an effective method for establishing the correct level of surveillance, identifying risk areas and negative trends, and determining the need for interim contacts and examinations. The reports are detailed, and the ART believes the process could be further enhanced through the development of a summary report to identify high risk credit unions.

#### **Follow-up Procedures**

Policies and procedures are in place for tracking responses and conducting follow up on examinations based on the examination findings, the severity of any problems and the composite CAMEL rating.

Problems noted during an examination and required corrective actions are included in the examination report. The credit union is required to respond in writing within 30 days after the report is issued stating that the corrective action has been taken or in progress. The credit union specialists maintain a tickler file to track the response. Responses are reviewed by the EIC to determine that the action taken is adequate or whether additional follow up is required. Credit unions not responding within 30 days are contacted by phone, then letter.

When there are examination issues found serious or severe enough to pose an imminent threat to the survival of the credit union or there is failure by the credit union to take corrective action, the Department may issue an order or a Letter of Understanding and Agreement (LUA). Credit unions under an LUA are subject to quarterly follow up examinations.

Continued failure to respond results in referral to the portfolio manager and become subject to administrative actions, which can include a Letter of Intent to Issue Orders, Cease and Desist Order, civil money penalties, or suspension or removal of personnel.

### **Enforcement Authority and Use**

The formal enforcement powers of the Department are defined in the Financial Code and include the power to remove officers, directors, and employees; issue cease and desist orders; close a credit union, and impose civil money penalties. Initiation of a formal enforcement action may occur following failure to comply with a Letter of Understanding. A formal enforcement action may proceed following notice to the credit union and opportunity for a hearing; however, it may go forward immediately if there is imminent danger to the credit union. In those instances, after the action is taken, the credit unions officers, directors, or employees have the right to request a hearing on the action.

### **Supervision of Corporate Governance and Other Supervisory Activities**

The statutes grant discretionary power to the commissioner to approve credit union applications for expansions to fields of membership and to grant variances to certain commissioner's rules. The statute defines the financial data and organizational information that must be considered by the Department in exercising its discretionary authority. The Department may also consider the management's adherence to rules, regulations and good business practices, and the activities of the credit union's board and committee activities. The Department provides regulatory and policy guidance through its website, and the DFIMonthly Bulletin.

### RATINGS SHEET (Supervision)

V. Supervision	Value	ART Rating	ART Score
A. System for Off-Site Monitoring	10	4	40
B. Procedure for Follow Up/Ensure			
Corrective Action	10	4	40
C. Enforcement Authority	10	5	50
D. Use of Enforcement Authority	10	4	40
E. Policies and Procedures for Corporate			
and Other Supervisory Activities	10	4	40
Total	250		210
			84.00%

### ***RECOMMENDATIONS (Supervision)***

- 1) That a summary report form be developed to identify high risk credit unions.

## **VI. LEGISLATIVE POWERS**

### **FINDINGS**

#### **Credit Union Code - Frequency of Revision and Involvement of the Department**

The Financial Code as it relates to credit unions is sufficiently up-to-date. The Code is reviewed on an ongoing basis and updated as deemed necessary. A full-time legislative staff monitors proposals affecting all of the department's licensees, including credit unions. The legislative staff, working with the deputy commissioner and the Division's legal staff, coordinates the Division's legislative program and advocacy efforts on behalf of the Division.

As a Department within the Building, Transportation and Housing Agency, legislative proposals initiating from the Division must be approved by the Agency. Approval by the Agency and the governor's office is required for the Department to sponsor legislation.

#### **Credit Union Supervisor - Statutory Responsibility and Authority**

The duties and responsibilities of the commissioner of financial institutions and the deputy commissioner of financial institutions for credit unions are clearly stated in the statute, and the statute provides adequate authority to administer the laws with respect to credit unions. As noted in the Description of the Department and the Examination and Supervision Sections of the ART's review, the Department's authority to license credit unions, require financial reports, assess fees, examine, supervise, and take enforcement actions are clearly defined.

### RATINGS SHEET (Legislative Powers)

VI. Legislative Powers	Value	ART Rating	ART Score
A. Frequency of Revision of Updating	4	5	20
B. State CU Supervisor-Responsibility			
and Authority	10	5	50
C. Involvement in Legislative Process	6	4	24
Total	100		94
			94.00%

### ***RECOMMENDATIONS (Legislative Powers)***

None

Final Score Sheet  
for the  
State of California

	Rating Ranges/ MAX	ART Score	ART %    Score
Section I - Administration/Finance	470	448	95.32%
Section II - Personnel	160	123	76.88%
Section III - Training	230	191	83.04%
Section IV - Examination	740	646	87.30%
Section V - Supervision	250	210	84.00%
Section VI - Legislative Powers	100	94	94.00%
Department Total	1,950		
ART Total Score		1,712	
ART Total Percentage (Score v. MAX Total)	100%		87.79%

### **BIOGRAPHY OF TEAM CAPTAIN: ROGER W. LITTLE**

Roger W. Little is a Deputy Commissioner of the Michigan Office of Finance and Insurance Regulation. Mr. Little has worked at OFIR since 1984, serving in various capacities including Regional Supervisor in both the Credit Union and Bank and Trust Divisions. He currently serves as Director of the Credit Union Section, responsible for the regulation of Michigan's 297 state-chartered credit unions, which hold assets totaling \$13 billion.

Mr. Little is a member of the Board of Directors of the National Association of State Credit Union Supervisors (NASCUS). He served as NASCUS Chairman in 2005 and 2006. He also serves on the Performance Standards Committee, and the Member Business Lending, Corporate Credit Union, and Privacy task forces. He has been active in both NASCUS and CSBS, and prepared the Self-Evaluation Report for Accreditation for Michigan's initial NASCUS accreditation in 1989.

Roger graduated with honors from Central Michigan University, and is a CPA. He also completed the Graduate School of Banking program at Louisiana State University after being selected as the first place candidate in a CSBS national scholarship competition.

### **BIOGRAPHY OF TEAM MEMBER: JERRIE K. JAY**

In 1996, the North Carolina Department of Commerce Secretary named Jerrie K. Jay Administrator of the North Carolina Credit Union Division. Ms. Jay oversees the agency that regulates North Carolina's 64 state chartered credit unions with 1,997,733 members and \$19,026,024,989 in assets. Before joining the Credit Union Division, Ms. Jay served as agency legal specialist for the North Carolina Department of Revenue. There she acted as counsel for the Motor Fuels Tax Division and managed the licensing, bonding and bankruptcy sections. Ms. Jay has numerous years of experience in asset and litigation management for a major national financial institution and a nationwide property and casualty insurer.

Ms. Jay holds an undergraduate and a law degree from the University of South Carolina. She is admitted to practice in the South Carolina Courts, the United States District Court, District of South Carolina, the United States Court of Appeals, Fourth Circuit and the Supreme Court of the United States of America. Ms. Jay has been a member of several legal organizations including the South Carolina Bar Association, American Bar Association, the North Carolina Association of Women Attorneys, the Association of Trial Lawyers of America and the American Judicature Society.

Ms. Jay currently serves on the Board of Directors of the National Association of State Credit Union Supervisors (NASCUS). She served as NASCUS Chairman from 2001 to 2004.

### **BIOGRAPHY OF TEAM MEMBER: MARY ELLEN O'NEILL**

Mary Ellen O'Neill is Director of the Financial Institutions Division for the Connecticut Department of Banking. In her position, she is responsible for the day-to-day operations of the Division and for ensuring the safety and soundness of Connecticut's state-chartered banks,

credit unions and other licensed entities including foreign banking offices and business and industrial development corporations.

Ms. O'Neill held the title of Director of the Bank Examination Division since December 1, 2000, until her appointment as Director of the Financial Institutions Division. Prior to that, she served as Division Assistant Director, and held a number of examiner positions. She received a Bachelor of Science degree and later a Master of Business Administration degree both from Quinnipiac University.

Ms. O'Neill has long been an active participant in various committees and educational conferences sponsored by the Conference of State Bank Supervisors (CSBS). She currently serves on both the CSBS State Supervisory Processes Committee and International Committee. In addition, she holds the CSBS Examiner Certification of Certified Examinations Manager. Ms. O'Neill is currently serving as a member of the National Association of State Credit Union Supervisors (NASCUS) Legislative and Regulatory Affairs Committee and the NASCUS Federal Affairs Subcommittee. Ms. O'Neill is also a member of the Connecticut Chapter of Infragard.

#### **BIOGRAPHY OF NASCUS STAFF: BARBARA POGUE**

Barbara Pogue joined NASCUS in January 2001 and currently serves as Senior Vice President of Corporate Affairs and Accreditation. Prior to joining NASCUS, Barbara was employed for several years as a senior aide to a Member of Congress and more recently as government affairs and political action coordinator for an international insurance and healthcare risk management consulting corporation.